

Economic conditions in Germany

Macroeconomic situation

Further slow-down in economic growth ...

Economic growth weakened further in the summer. According to the Federal Statistical Office's flash estimate, quarter-on-quarter growth in real gross domestic product (GDP) was 0.2% in the third quarter of 2012 after seasonal and calendar adjustment, compared with increases of 0.3% in the second quarter and 0.5% in the first quarter. In the period under review, the German economy made no more than an isolated showing of the strengths which had broadly characterised it in the strong recovery period of 2010 and 2011. Exports, for instance, expanded perceptibly despite the cooling in the world economy, principally on account of a strong pick-up in foreign demand for motor vehicles. Domestic demand continued to receive stimuli from residential construction and household consumer spending. This partial impetus

has been enough so far to keep overall economic output within the range of normal capacity utilisation.

The economy currently presents a mixed picture overall, which is very likely to become even gloomier towards the end of the year. The uncertainties emanating from the smouldering sovereign debt crisis in the euro area are just as important in this context as the mixed economic signals from other regions of the world. Although households are still benefiting from the favourable labour market situation and considerable increases in income, the economic uncertainties are also clearly reflected in the outlook.

... and gloomier outlook

All in all, foreign trade in the second half of 2012 has been marked by the pattern that prevailed in the first half of the year, with export growth largely reliant on non-euro-area countries, whereas the euro-area countries are showing a growth lead in imports, which are expanding rather moderately overall. Moreover, there has been a further considerable increase in the overall German trade surplus. Even so, the reduction in the trade surplus with euro-area partner countries came to a halt, because German firms were selling perceptibly more goods in the euro area again in July and August following a lean period of nine months. Significant growth in exports was again achieved in traditional sales markets such as the USA, Japan and the United Kingdom. By contrast, performance in exports to central and eastern European countries and Russia was rather weak. This was also true of the new industrial economies in Asia and, in particular, China.

Impetus from foreign trade

However, growth in exports in the quarter under review was generated not by a broad expansion in foreign demand across various categories of goods, but by the extraordinary export success enjoyed by German car manufacturers in the summer months. They achieved

Exports sustained by motor vehicle sales



this solely outside the euro area, with automotive exports to the USA playing a prominent role. While producers of information and communication technology (ICT) products and electrical equipment recorded a small increase in exports in July and August, manufacturers of machinery and equipment were already suffering a slight decline in export sales. In the intermediate goods industries there is likely to have been, at most, a small increase in the third quarter. Manufacturers of consumer goods may have performed somewhat better.

Imports characterised by large-volume deliveries

In terms of imports, capital goods stood out during the reporting period. Apart from the fact that there were significantly more imports of motor vehicles and motor vehicle parts in July and August, a role was also played by the delivery of ships as well as aircraft and spacecraft to German customers. By contrast, considerably less machinery was sourced from abroad. There was a somewhat stronger demand for intermediate goods in the summer months, following the decline in the previous quarter. Whilst imports of consumer goods remained unchanged, energy imports showed a sharp decline.

Corporate investment still weak

The trend weakness in corporate investment is likely to have continued in the third quarter. Firms' investment plans were already becoming more cautious one year previously, when the economic upturn slowed down considerably in the wake of the escalating sovereign debt crisis, and industry, in particular, had to accept cuts in the utilisation of production capacity. There is, at present, a lack of optimism about the likelihood of new economic impulses in the short term. In addition to the investment budgets, staffing levels are therefore also increasingly undergoing a rethink. Thus, the recovery in capital investment, which began in impressive fashion in 2010 and continued in an attenuated form in 2011, was now not only halted in midstream but also suffered a considerable setback at the end of the period under review. The investment ratio, which shows business investment in commercial machinery

Underlying trends in foreign trade

Seasonally adjusted, quarterly

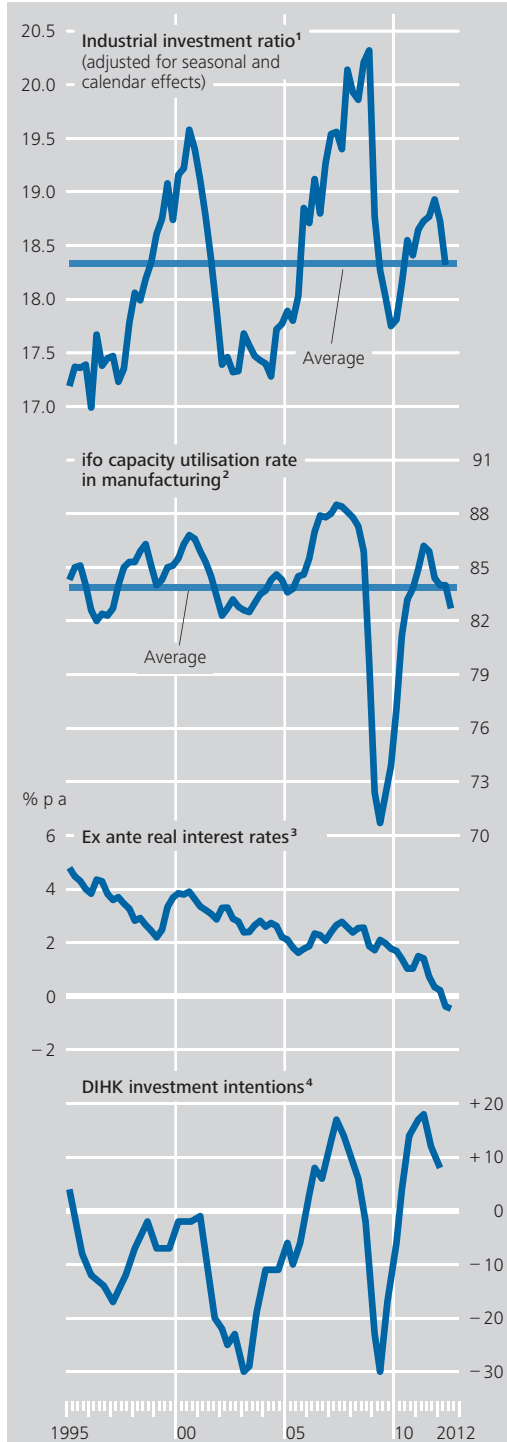


1 Adjusted for the price indices for foreign trade.
 Deutsche Bundesbank

and equipment and construction in relation to enterprises' value added and which serves as a measure for the cyclical component, fell back down to the longer-term average figure in the first half of 2012, after being clearly above it at the end of 2011. Up to that point, just under half of the decline due to the deep recession in late 2008 and early 2009 had been recovered. Enterprises' current hesitancy to invest highlights the fact that favourable financing conditions do not necessarily generate an expansionary impulse if the investment climate is impaired by confidence effects caused by appreciably gloomier expectations and a continuing high level of uncertainty.

Indicators of industrial investment

Quarterly



1 2005 ratio (at current prices), extrapolated in line with the change factors of the price-adjusted ratio (= ratio of change factors of private gross fixed capital formation excluding residential buildings and the real gross value added of the business sector excluding real estate activities, all at previous year's prices). **2** As a percentage of normal full capacity. Quarterly averages. **3** Calculated using bearer debt securities with a maturity of nine to ten years and survey-based consumer price inflation expectations calculated by Consensus Forecasts. **4** Balance of "higher" and "lower" reports as a percentage of the surveyed enterprises. Two surveys per year until 2001, subsequently three surveys per year.
 Deutsche Bundesbank

By contrast, decidedly favourable interest rate conditions and the uncertain financial market climate are giving a clear boost to housing construction. The continued robust demand for residential property for both owner occupation and investment purposes is not only driving up housing prices but also providing further impetus to the construction sector. Public sector construction, on the other hand, has fallen far behind. In the first half of 2012, government infrastructure measures were one-seventh below the previous year's figure in seasonally adjusted terms. As this mainly reflects the fact that lagged effects of the fiscal stimulus package at the turn of 2008-09 are petering out, it may be assumed that the reduced level shaped public sector construction investment in the reporting period, too.

Housing construction still in forward gear, but public sector construction very depressed

According to a press release by the Federal Statistical Office, there was a seasonally adjusted increase in private consumption in the third quarter of 2012. As before, supporting factors included the positive labour market situation and sharp wage increases. Even though price increases have curtailed households' real spending power *per se*, consumer expenditure has remained high. Consumers' propensity to save declined, not least because of very low interest on credit balances. This is also shown by the survey findings of the consumer research institution, *Gesellschaft für Konsumforschung* (GfK). Nevertheless, retail sales declined somewhat in the third quarter in seasonally adjusted terms. The fact that there was no more than a slight decline in the number of new private passenger car registrations points to a continuing high level of consumer spending on the purchase of cars.

Renewed growth in private consumption

■ Sectoral trends

Seasonally adjusted industrial output rose only moderately by ½% in the third quarter compared with spring. However, capital goods manufacturers sharply expanded their output again (+2¼%) on a quarterly average. A major

Moderate rise in industrial output

part in this was played by production in the automotive industry, which rose by 6½%. This was assisted by the fact that some automotive plants did not interrupt production in the summer given the continuing high level of demand, particularly from abroad. If the automotive sector is excluded, output of capital goods remained at the same level as in the previous quarter in seasonally adjusted terms. Whilst manufacturing in the mechanical engineering sector showed only a marginal decline, manufacturers of computers, electronic and optical products as well as electrical equipment recorded a distinct decrease of 1¾%. In the intermediate goods sector, output was a seasonally adjusted 1¼% down on the quarter. Production of consumer goods, which had been in decline since the previous summer, went up by 1%, however.

Industrial capacity well below normal utilisation

The considerable decline in industrial output in September indicates that the fairly large volume of production in July and August, which was shaped by special factors, will not be matched in the short term. The prospect that neither domestic nor external demand will pick up dramatically in the coming months is likely to lead to further adjustments in industrial firms' output. This is also borne out by the considerable decline in manufacturing capacity utilisation, which, according to the Ifo surveys, enterprises expect for the final quarter of 2012. At 82% of full operational capacity utilisation, industry is clearly falling short of the longer-term average, which can be interpreted as a measure of normal capacity utilisation. In terms of the reported decline and failing to match the longer-term sectoral average, the shortfall among producers of capital goods was larger than in the intermediate goods sector.

Construction activity still strong, energy output higher

In the third quarter of 2012, seasonally adjusted construction output was ½% up on the second quarter, which was affected by weather-related catch-up effects. Civil engineering activities showed a somewhat stronger increase than those in building construction. Construction activity remained decidedly buoy-

Output in industry and in construction

2005 = 100, seasonally adjusted, quarterly



Deutsche Bundesbank

ant overall and this is also reflected by the fact that, according to the Ifo Institute, capacity utilisation in construction machinery in the third quarter held up at the high level of the previous three-month period and there was an increase in the backlog of orders. After seasonal adjustment, energy output increased markedly (+1¾%) in the summer compared with the second quarter.

The pace of economic activity in the services sector was more subdued in the third quarter. This is suggested by the business situation assessments of service providers surveyed by the Ifo Institute and the Centre for European Eco-

Activity in the services sector somewhat more subdued

conomic Research (ZEW), which became somewhat less positive in the third quarter of 2012. The dampening of industrial activity may have affected the activities of service providers, which are closely interlinked with output in manufacturing. This is borne out, for example, by the fact that there was a slight seasonally adjusted decrease in the mileage of domestic heavy goods vehicles subject to tolls on motorways.¹ There were also slight decreases in the sales of the wholesale trade. Automotive trade sales remained at the level of the previous quarter. Consumption-related service providers were likewise not entirely immune to the general deceleration either. Retail sales deteriorated somewhat. Hotels' and restaurants' turnover was up on the second-quarter level, however. Although construction-related service providers continued to benefit from the positive situation in the construction sector, there are no signs of positive stimuli either.

Employment and labour market

Economic headwind reaches labour market

The economic slowdown is increasingly leaving its mark in the labour market. During the summer, the expansion in employment came to a standstill,² and there was a marked seasonally adjusted increase in unemployment. The cyclical effect was the decisive factor in this. This is currently masking the fact that the German labour market still has an exceptionally large absorption capacity given an ongoing high level of immigration, a trend rise in labour force participation and marked caution with regard to the deployment of labour market measures.

Growth in employment grinds to a halt

On an average of the summer months, the seasonally adjusted employment level in Germany was slightly up on the second quarter by 39,000 persons, or 0.1%. This growth was due solely to the positive development in employment subject to social security contributions, whilst other forms of employment were declining. Taking July and August together, after seasonal adjustment, around 65,000 additional

jobs subject to social security contributions were filled. This corresponds to an increase of ¼%. Further new jobs were created in the manufacturing and logistics sectors. The fact that the effective demand for labour is tending to stagnate in these sectors becomes clear, however, if the gain in permanent jobs subject to social security contributions is offset against the decline in the temporary employment sector, often in the cyclically sensitive sectors. The largest increase in employment was in some service sectors, including business-related services, (excluding temporary agency employment), information and communication as well as healthcare with growth of more than ½% on the quarter. According to estimates by the Federal Statistical Office, total employment in September was down on the month in seasonally adjusted terms.

In addition to the stronger activation of unemployed persons and persons outside the labour force, enterprises' demand for labour to date has been covered mainly by the inflow of labour from abroad. In the current year, the migration surplus may considerably exceed the previous year's figure of 279,000 persons. The figure for immigration was 135,000 higher

High immigration this year to date

¹ Since 1 August 2012, the motorway toll for heavy goods vehicles is generally also imposed on longer sections of road with at least four lanes and unidirectional traffic, direct motorway connection and without thoroughfares through towns and cities. Previously, only a few sections of trunk roads were subject to tolls. The data published by the Federal Office for Goods Transport make it possible to segment routes, covered on motorways or trunk roads by heavy goods vehicles subject to tolls. Using these allows the time series for mileage on motorways, which have been available since 2007, to be projected without a statistical break. In addition, total mileage data on motorways and trunk roads are available from the reporting month of August 2012. The percentage of the route travelled on trunk roads is quite small; on an average of August and September, it was merely 2½%. The use of toll statistics in the economic analysis is addressed, for example, in Deutsche Bundesbank, Information content of toll statistics for economic analysis, Monthly Report, May 2010, pp 64-65, and R Döhrn (2011), Die Mautstatistik: Keine 'Wunderwaffe' für die Konjunkturanalyse, Wirtschaftsdienst 91, 12, p 863ff (in German only).

² Moreover, in its latest published data, the Federal Statistical Office has revised downwards employment growth since the beginning of the year. According to new data, the increase in employment was a seasonally adjusted 0.1% in the second quarter (previously 0.2%) compared with the preceding period.

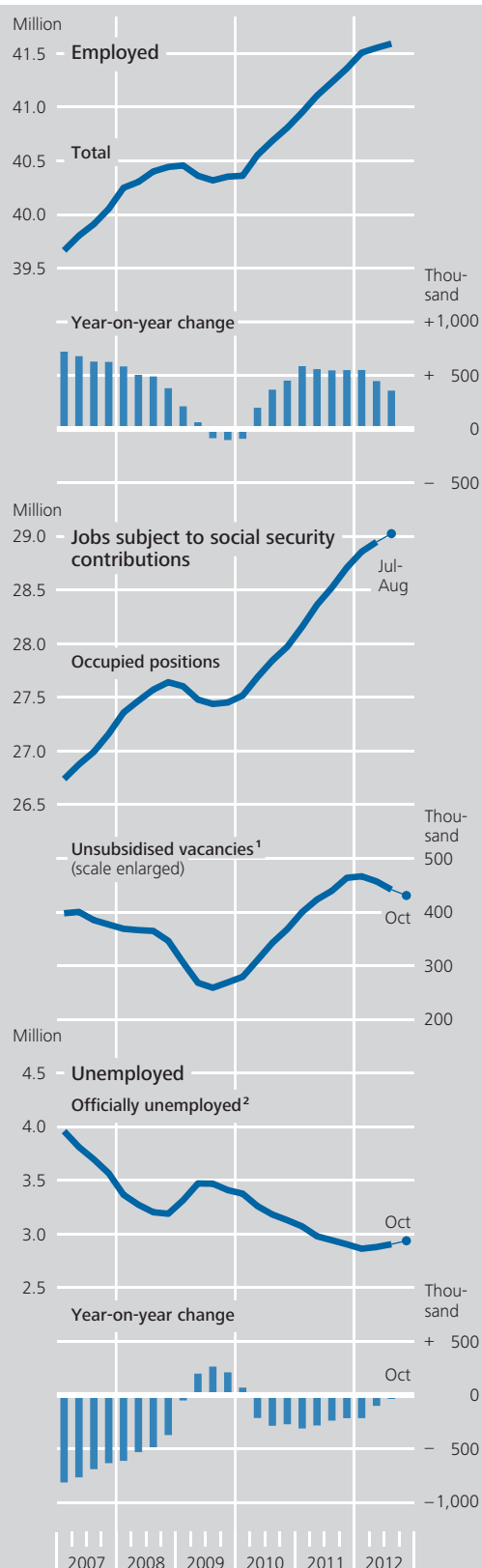
than for emigration in the first half of 2011, with the provisional data of the Federal Statistical Office showing the comparable balance this year at 182,000. With a share of roughly one-third, the eight central and east European EU member states (EU 8) are still the most significant region of origin. In comparison with the period immediately after 1 May 2011, when nationals of these countries were granted complete freedom of movement, immigration has receded only slightly. The influx of Romanian and Bulgarian citizens is substantial despite the fact that they have not been granted complete freedom of movement. The migration movements between Germany and the south European peripheral euro-area countries are still such that they are tending to alleviate the sometimes very difficult labour markets in those countries. The migration surplus with regard to Greece, Italy, Spain and Portugal was 30,000 in the first half of 2012, which was more than twice as high as in the comparable period of 2011.

Marked increase in registered unemployment

There was an accelerated rise in unemployment in the third quarter of 2012, following only a slight increase in spring. After seasonal adjustment, the unemployment figure went up by 26,000 to 2.9 million. The unemployment rate remained unchanged at 6.8% during the reporting period. Here, it was evident that the high level of immigration and higher labour force participation led to an increase in the number of persons in work. The rise in official unemployment can be explained in mathematical terms by the seasonally adjusted 35,000 increase in the number of unemployed persons claiming insurance benefits (SGB III) to 915,000. On account of the economic situation, not only was there a somewhat higher number of newly registered unemployed, the probability of finding a new job also decreased. By contrast, up to September, there was a fall in the number of unemployed persons receiving the basic welfare allowance. October 2012 saw a further marked rise in the overall official unemployment figure. The unemployment rate was 6.9%.

Labour market

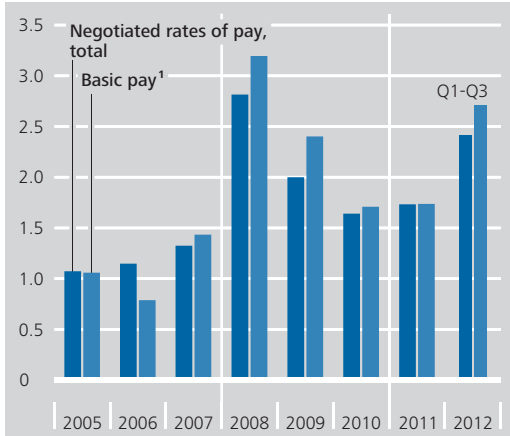
Seasonally adjusted, quarterly



¹ Excluding seasonal jobs and jobs located abroad. ² From May 2009, unemployed excluding persons newly registered on the books of private employment agencies.

Negotiated rates of pay

Year-on-year percentage change, on monthly basis



¹ Excluding additional benefits and lump-sum payments.
 Deutsche Bundesbank

Mainly larger industrial enterprises see need for adjustment

The cyclical headwind will also shape the final quarter of 2012 and first three months of 2013. The Ifo employment barometer, which provides information on planned staffing levels in the business sector over the coming three months, fell sharply again in the third quarter of 2012. The Ifo Institute's manager survey of August 2012 indicates that it is mainly industrial enterprises which have a need to adjust.³ What is striking, moreover, is that it is larger enterprises (with more than 500 employees) which are thinking more of reducing the number of temporary workers and allowing limited-term contracts to expire, whereas smaller and medium-sized firms want to make provision for the foreseeable smaller amount of work by working less overtime and running down working time accounts. The instrument of short-time working will still be used only to a small extent in the immediate future. The number of applications for short-time work is still at an insignificant level in macroeconomic terms, even though there was a clear rise in August and September. According to the autumn survey of the Association of German Chambers of Commerce and Industry (DIHK), companies' hiring intentions for the next 12 months have slipped into neutral territory.

Fewer vacancies

The survey results are consistent with the fact that there has been a marked seasonally ad-

justed decline in both the level of vacancies and the number of newly registered vacancies. The number of vacancies for jobs subject to social security contributions fell by 15,000 on the quarter, although other business-related services account for two-thirds of this decline. Vacancies of temporary employment agencies are recorded in this category. There were also fewer vacancies in manufacturing, construction and trade.

Wages and prices

In the second half of 2012, pay settlements at the cooperative banks and in the textile and clothing industry saw two agreements in small branches. This is striking mainly because, in both cases, the total volume involved was distinctly lower than in the settlements in the first half of the year.⁴ The overall substantial percentage pay increases in this year's wage-bargaining round are now being clearly reflected in the overall level of wages in the economy. According to the Bundesbank's negotiated pay rate statistics, the year-on-year rate in negotiated rates of basic pay showed a further rise of 2.9% in the third quarter of 2012, following 2.7% in the second quarter.⁵ Negotiated rates of pay including all ancillary agreements, at +2.7% on the year, were also higher than in the second quarter (+2.6%). The upward trend in negotiated pay was more marked in the production sector than in the services sector. In the reporting period, actual

Continued upward movement in negotiated wages

³ Ifo Institute's telephone survey covered 630 managers from the sectors of manufacturing, construction, the wholesale and retail trade, and services.

⁴ When interpreting the agreement for the textile and clothing industry, it should be borne in mind that major parts of this sector, such as the manufacture of technical textiles, have indeed benefited from the economic tailwind as a supplier, for example, of the automotive industry. The collective labour agreement takes account of the considerable heterogeneity within the industrial sector through numerous elements of flexibility.

⁵ The Federal Statistical Office reports an increase of 3.2% in the summer for negotiated rates of basic pay, following 2.2% in spring. Differences compared with the Bundesbank's pay index also result from the fact that the Federal Statistical Office does not include civil servants in its index and reports only the first month of each quarter.

earnings are likely to have risen at the same pace as negotiated rates of pay.

Higher wage costs in temporary employment

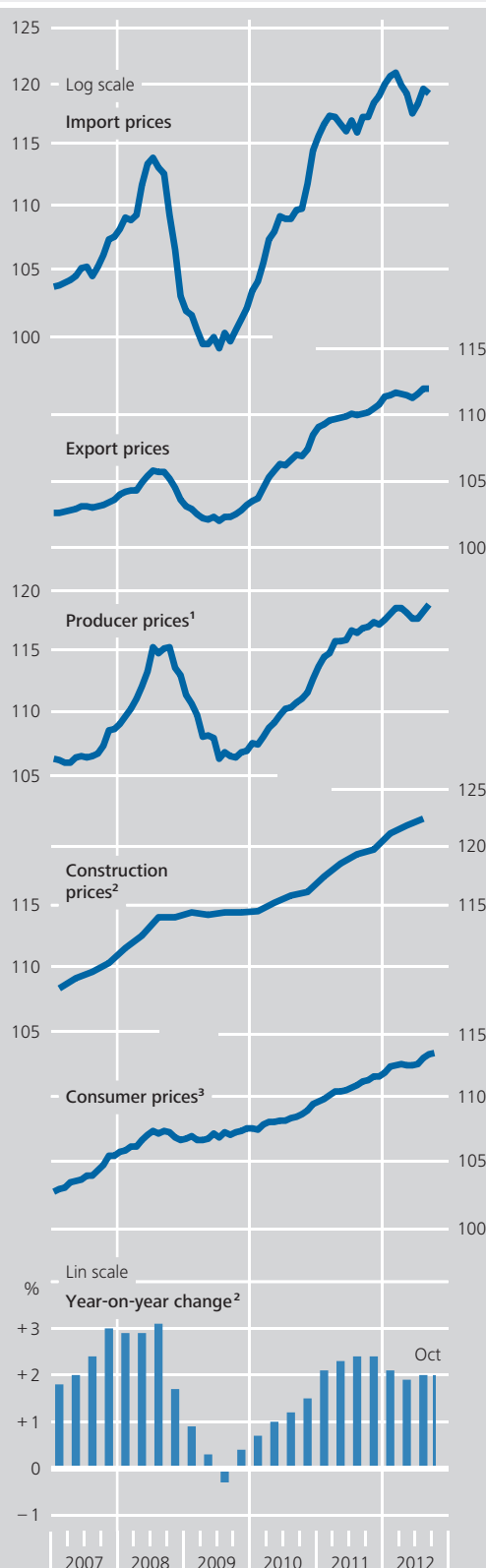
Temporary employment agencies have to face an added double strain in terms of their costs. First, on 1 November 2012, the generally binding lower thresholds for the hourly wage in temporary employment were raised to €8.19 in western Germany (+3.8%) and €7.50 in eastern Germany including Berlin (+7%). Secondly, the collective settlement agreed in spring in the metal-working and electrical engineering industries as well as in the chemicals sector entered into force at the same time. This stipulates that rising wage add-ons are to be paid in line with the length of contract.⁶ It remains to be seen to what extent the agencies manage to pass on the additional costs to the hiring firms in an increasingly bleak economic environment, especially for the temporary employees. In the long term, this measure is likely to increase the cost of using temporary employment as an instrument for making the deployment of labour input more flexible.

Only very moderate rise in import and producer prices

Whilst consumer price inflation accelerated in the third quarter, price increases were tending to remain moderate at the upstream stages of the economy. However, short-term volatility was considerable, with oil prices and exchange rates both playing a part. Seasonally adjusted import prices increased only marginally overall (0.1%) on an average of the quarter in spite of the further perceptible depreciation of the euro in July. The same is true of domestic producer prices, which are closely linked to the global market and, thus, to import prices. The global economic lull has made itself felt so far in the decline in intermediate input prices from foreign and domestic production. The prices of finished goods, on the other hand, continued to rise, with a larger increase in consumer goods than in capital goods at both domestic

Import, export, producer and consumer prices

2005 = 100, seasonally adjusted, monthly



⁶ A similar arrangement for the incremental payment of wage add-ons to temporary workers has since been agreed by both sides of the textile and clothing industry and the wood and plastics processing industry and will come into effect on 1 April 2013.

¹ Producer price index for industrial products in domestic sales. ² Not seasonally adjusted, quarterly. ³ National consumer price index.
 Deutsche Bundesbank

producer and import levels. The upward trend in food prices played a part here. There was little change in energy prices despite crude oil becoming more expensive, mainly for exchange rate reasons. This was due to sharp cuts in gas prices, which are becoming more and more decoupled from crude oil prices. As domestic exporters were able to impose somewhat higher price increases overall, the terms of trade improved slightly, but were still below their level of 12 months earlier. There were year-on-year increases of 2% for import prices and 1.4% for domestic producer prices.

Construction and property prices still rising

The rise in housing construction prices continued to ease, so that the year-on-year rate fell to 2.5%. Lower prices for intermediate goods might possibly have had an alleviating effect. Nevertheless, an easing on the demand side does not seem imminent. There is still a major need for residential property, which is also driving up house prices. According to the Association of German Pfandbrief Banks (*Verband deutscher Pfandbriefbanken*), the price index for owner-occupied housing went up by 0.4% compared with the second quarter. The annual rate was 2.7%.

Increase in consumer prices stronger initially ...

The increase in upward pressure on consumer prices in the third quarter to a seasonally adjusted 0.4% on the quarter (following a rise of 0.2% in the spring) was due to the energy component. Both the depreciation of the euro and the rise in crude oil prices played a part in this. The increase in food prices, in turn, was quite strong, and was probably due not only to weather effects but also a rise in transport costs and a weaker euro. By contrast, the price trend for other goods (excluding energy and food) became perceptibly calmer. Rises in the prices of services and in housing rents remained within narrow bounds. Annual Consumer Price Index (CPI) inflation went up slightly from 1.9% to 2.0%. According to the Harmonised Index of Consumer Prices (HICP), the rate was unchanged at 2.1%.

After seasonal adjustment, consumer prices increased only moderately (+0.1%) in October, despite a further rise in food prices. However, this was offset by falling fuel prices. The year-on-year increase remained unchanged in both the CPI and the HICP at 2.0% and 2.1% respectively.

... but weakened of late

■ Orders received and outlook

Confidence that the economy will pick up in the near future is fading in ever more areas of the economy. Uncertainty about the extent of losses in external demand in view of the slower pace of global economic growth and the severe adjustment crises in parts of the euro area has so far primarily hampered the export-based industries. However, it has now become obvious that these interfering external factors are having such a strong impact on the willingness to invest and on employment planning that the economy at large might suffer. Following on from investment activity losing all momentum a year ago, the upward trend on the labour market has now also come to a halt. Service providers geared predominantly to the domestic economy are currently downgrading their business expectations considerably and thus following a general tendency that took hold in the manufacturing industry some time ago. Currently, only residential construction and consumer spending are able to withstand the marked dampening factors.

Gloomier economic picture spreads ...

The risk that the mixed economic outlook may become entrenched is documented in the findings of the most recent DIHK economic survey. There has been a steep drop in enterprises' business and export expectations. The results confirm the trend discernible from Ifo Institute surveys for the past six months. The fact that as many as two-fifths of the surveyed enterprises cite the underlying economic policy conditions as a major risk for business development in the coming year can be interpreted as an indication of deep-seated uncertainty. This is also suggested by the fact that the calming in the fi-

... and major uncertainty persists

nancial markets since the summer has raised the economic expectations of the financial market players, but has not so far been reflected positively among the enterprises themselves.

Orders in reverse gear

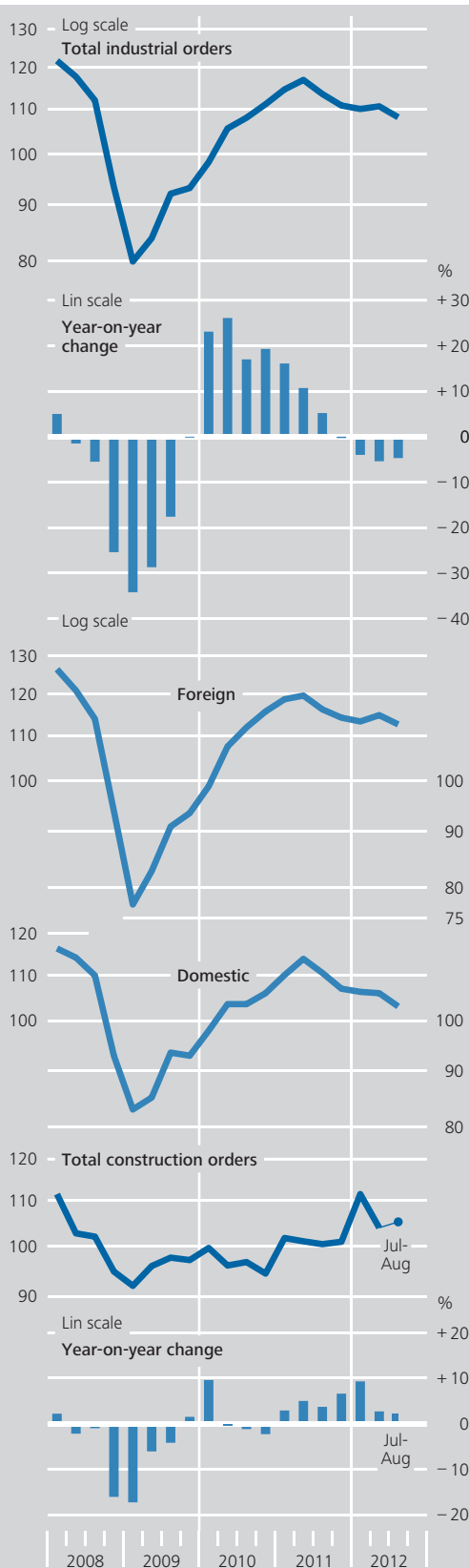
In summer 2012, industrial new orders fell considerably by a seasonally adjusted 2¼% on the second quarter. This decrease in orders was broadly based across regions. Whilst demand from non-euro-area countries did not decline quite so sharply (-1¼%), not least owing to large orders, demand for industrial goods made in Germany was weak at home (-2¾%) and in the rest of the euro area (-3%). Orders for capital goods saw a particularly sharp downturn in the reporting period. Somewhat more orders were received in the second quarter for the first time since the previous summer, but this was followed by a decline of 2¾% suffered in the third quarter of 2012. Export customers also ordered fewer motor vehicles as well as less machinery and equipment (-2¼%). However, the downward pressure caused by the German economy's current low propensity to invest was considerably greater (-3½%). This is revealed, for example, by domestic mechanical engineering orders declining by 4¼% in seasonally adjusted terms. There were considerable falls in both domestic and export demand in the automotive industry. Even bearing in mind the fact that export orders attained a very high level again in the second quarter, this finding should be regarded as a cause for concern in view of the scale of the correction during the third quarter. Given the current mixed economic picture, enterprises distinctly cut back their orders of intermediate goods, too, in the reporting period (-2% after seasonal adjustment). By contrast, orders of consumer goods fell only slightly (-¼%) in the third quarter.

Construction activity still on upward trend

The construction industry is still enjoying a fairly constant flow of orders at a high level. The volume of construction orders in July and August – more recent statistical data are unavailable – was a seasonally adjusted 1¼% up on the preceding three-month period. New building con-

Demand for industrial goods and construction work

Volume, 2005 = 100, seasonally adjusted, quarterly



struction permits in this period were not granted to quite the same extent as on an average of the spring months. This was because commercial construction had to cope with a reduction from the elevated level of the previous quarter. There was little change in housing construction, as in public sector projects. This means that, although homes and apartments are likely to go on being constructed in large numbers, it will not be possible to overcome the slowdown in public sector construction in the near term.

The basic prerequisites for private consumption supporting the economy are still in place. This

is indicated by the fact that consumer sentiment has improved from a high level since the summer. Much as in the case of the financial markets, consumers have obviously drawn fresh hope. According to the GfK surveys, their expectations have therefore recently risen somewhat from their earlier depressed level. In this context, income expectations and the propensity to purchase remained stable, especially as the effects of possible changes in the assessment of the labour market outlook will only become visible in the coming months.

*Robust growth
in private
consumption*